

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
ARMOR STEEL COMPANY, INC.)

For Appellant: Arthur C. Green
 Certified Public Accountant

For Respondent: Charlotte A. Meisel
 Counsel

O P I N I O N

This appeal is made pursuant to section 26075, subdivision (a), of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Armor Steel Company, Inc., for refund of franchise tax in the amounts of \$7,982 and \$25,125 for the income years ended June 30, 1977, and June 30, 1978, respectively.

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The issue presented in this appeal is whether appellant may retroactively increase its reserve for bad debts.

On its franchise tax **returns** for the income years ended June 30, 1977, and June 30, 1978, appellant, having elected the reserve method of accounting for bad debts, deducted additions to its reserve for bad debts. Later, appellant apparently hired a new accountant who determined that the additions were not adequate. Amended returns for the income years at issue were filed in August 1981, deducting larger additions and claiming refunds. Respondent denied these claims for refund, and this appeal followed.

Section 24348, subdivision (a), of the Revenue and Taxation Code allows the taxpayer a choice of two mutually exclusive methods of accounting for bad debts. These are: (i) the deduction of specific debts which become worthless during the year: or (ii) in the discretion of respondent, the deduction of a reasonable addition to a reserve for bad debts. If the taxpayer chooses the reserve method, the estimate of the bad debt reserve for any year must be made by considering conditions as they reasonably appear at the time the estimate is made. Once the taxpayer has made an addition to the reserve for a year and deducted that amount, it may not, in a subsequent year, alter that amount retroactively. (Farmville Oil & Fertilizer Co. v. Commissioner, 78 F.2d 83 (4th Cir. 1935); Appeals of Leight Sales Co., Inc., and G. L. Company, Inc., Cal. St. Bd. of Equal., June 29, 1982; Appeal of Hill Drive Rental Co., Inc., Cal. St. Bd. of Equal., Jan. 16, 1973.) If, in a later year, the prior estimate proves to be incorrect, the correction is properly made by adjusting the later year's addition. (Former Cal. Admin. Code, tit. 18, reg. 24348, **subd. (g)(2)(B)**, repealer filed Sept. 3, 1982 (Register 82, No. 37).) Appellant estimated the appropriate additions to its reserve for the income years 1977 and 1978 as of the end of those years and claimed a deduction for each year; it cannot, several years later, increase the additions and claim a larger deduction.

Appellant relies upon the Appeal of Culver Federal Savings and Loan Association, decided by this board on February 14, 1966. The taxpayer in that appeal had made an addition to its bad debt reserve for the income year 1959 but had neglected to claim a deduction in that amount on its 1959 return. We held that, under those circumstances, the taxpayer could, by amended return in a later year, claim a deduction in an amount not to

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exceed the addition made in 1959. Unlike appellant, the 'taxpayer in the Culver Federal appeal was not attempting to increase its addition to bad debt reserves **retroactively**. Therefore, that appeal does not support appellant's position.

For the above reasons, the action of respondent **must** be sustained.

Q_R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of Armor Steel Company, Inc., for refund of franchise tax in the amounts of \$7,982 and \$25,125 for the income years ended June 30, 1977, and June 30, 1978, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 27th day of June, 1984, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Collis and Mr. Bennett present.

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| <u>Richard Nevins</u> | , Chairman |
| <u>Ernest J. Dronenburg, Jr.</u> | , Member |
| <u>Conway H. Collis</u> | , Member |
| <u>William M. Bennett</u> | , Member |
| <u></u> | , Member |